Company Focus

1 February 2008 | 15 pages

Tata Motors (TAMO.BO)

Target price change ☑
Estimate change ☑
Results ☑

Buy: Revise Target Price to Rs 914

- **Revise target price** — TP of Rs914 from Rs1029 reflects our downward revision in EPS estimates over FY08/09e. Our valuation is based on a sum–of–parts methodology which values the core auto business at Rs657/share (from Rs827/share) and increases the value attributed to subsidiaries to Rs257 (from Rs202). Our downward revision in estimates is driven by lower volume assumptions (on MHCVs and cars) and attendant decline in EBITDA margins.
- **Core valuations** — Our core business value of Rs 657/share is based on 11x FY09E cash earnings which is well supported by a 21% cash earnings CAGR over FY08E-FY10E. We revert to our original P/CEPS methodology (from EV/EBITDA).
- **3QFY08 results** — Recurring PAT at Rs4.16 billion (-19%Y/Y but 8% above expectations) mainly driven by stronger than expected operating performance. EBITDA margins at 11.3 % were up 210 bps QoQ driven by higher realizations, richer product mix and lower material cost pressures. Balance sheet remains healthy – working capital norms remain strong, and net gearing is at 0.44x. Overall consolidated results were healthy – net profits at Rs6.54bn (+9%Y/Y).
- **Reiterate Buy (1L)** — We believe valuation remains attractive. However, Jaguar–Land Rover acquisition remains a key risk as the magnitude of overall acquisition (vis-à-vis TAMO's operations) and subsequent impact on earnings and balance sheet of TAMO will likely continue to create an overhang on the stock until clarity on the deal's structure emerges. We don't factor the impact of this acquisition into our estimates, given lack of information at this juncture.

Buy/Low Risk	1L
Price (31 Jan 08)	Rs706.15
Target price	Rs914.00
from Rs1,029.00	
Expected share price return	29.4%
Expected dividend yield	1.9%
Expected total return	**31.3%**
Market Cap	Rs270,579M
	US$6,885M

Price Performance (RIC: TAMO.BO, BB: TTMT IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	14,023	34.60	0.3	20.4	4.9	29.1	1.8
2007A	17,640	43.52	25.8	16.2	4.0	28.4	2.1
2008E	14,648	34.38	-21.0	20.5	3.4	19.6	1.8
2009E	17,030	39.98	16.3	17.7	3.0	19.7	1.9
2010E	21,487	50.44	26.2	14.0	2.6	21.6	2.3

Source: Powered by dataCentral

Jamshed Dadabhoy[1]
+91-22-6631-9883
jamshed.dadabhoy@citi.com

Hitesh Goel[1]
hitesh.goel@citi.com

See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	20.4	16.2	20.5	17.7	14.0
EV/EBITDA adjusted (x)	16.1	13.8	18.4	14.4	11.6
P/BV (x)	4.9	4.0	3.4	3.0	2.6
Dividend yield (%)	1.8	2.1	1.8	1.9	2.3
Per Share Data (Rs)					
EPS adjusted	34.60	43.52	34.38	39.98	50.44
EPS reported	37.72	47.21	42.07	39.98	50.44
BVPS	144.62	178.25	210.25	239.05	276.56
DPS	13.00	15.00	12.50	13.50	16.00
Profit & Loss (RsM)					
Net sales	201,695	268,103	267,327	313,774	386,844
Operating expenses	-185,686	-248,299	-251,760	-292,863	-359,415
EBIT	**16,009**	**19,805**	**15,567**	**20,911**	**27,429**
Net interest expense	-2,264	-3,131	-3,600	-4,752	-5,798
Non-operating/exceptionals	6,788	9,058	11,013	6,549	7,018
Pre-tax profit	**20,534**	**25,732**	**22,980**	**22,707**	**28,649**
Tax	-5,245	-6,597	-5,056	-5,677	-7,162
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**15,289**	**19,135**	**17,924**	**17,030**	**21,487**
Adjusted earnings	14,023	17,640	14,648	17,030	21,487
Adjusted EBITDA	16,009	19,805	15,567	20,911	27,429
Growth Rates (%)					
Sales	16.9	32.9	-0.3	17.4	23.3
EBIT adjusted	6.7	23.7	-21.4	34.3	31.2
EBITDA adjusted	6.7	23.7	-21.4	34.3	31.2
EPS adjusted	0.3	25.8	-21.0	16.3	26.2
Cash Flow (RsM)					
Operating cash flow	**15,289**	**19,135**	**17,924**	**17,030**	**21,487**
Depreciation/amortization	0	0	0	0	0
Net working capital	0	0	0	0	0
Investing cash flow	**-12,694**	**-17,920**	**-35,596**	**-42,582**	**-47,581**
Capital expenditure	-14,194	-25,447	-30,000	-30,000	-35,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**4,414**	**10,723**	**19,889**	**5,000**	**19,810**
Borrowings	4,414	10,723	19,889	5,000	19,810
Dividends paid	0	0	0	0	0
Change in cash	**7,009**	**11,937**	**2,218**	**-20,552**	**-6,284**
Balance Sheet (RsM)					
Total assets	**162,118**	**190,235**	**223,639**	**249,006**	**297,243**
Cash & cash equivalent	11,194	8,268	10,964	3,587	3,969
Accounts receivable	7,158	7,822	10,150	11,893	14,632
Net fixed assets	45,212	63,946	86,717	108,286	132,735
Total liabilities	**106,747**	**121,537**	**142,606**	**156,873**	**190,654**
Accounts payable	28,385	37,097	36,847	42,860	52,569
Total Debt	29,368	40,091	59,981	64,981	84,791
Shareholders' funds	**55,371**	**68,698**	**81,033**	**92,132**	**106,590**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	7.9	7.4	5.8	6.7	7.1
ROE adjusted	29.1	28.4	19.6	19.7	21.6
ROIC adjusted	26.2	18.4	10.7	12.2	13.2
Net debt to equity	32.8	46.3	60.5	66.6	75.8
Total debt to capital	34.7	36.9	42.5	41.4	44.3

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Powered by: dataCentral

Revise Target Price to Rs914

We revise our target price to Rs914 (from Rs1029) based on our sum-of-parts valuation methodology. We value Tata Motors' core business at Rs 657/share, which is based on 11x FY09E CEPS (previously at 9.2x FY08 EV /EBITDA), at the lower end of the recent trading band, and which should be comfortably supported by a 21% CAGR in cash earnings over FY08-10E. Over the past fiscal, the CEPS multiple has ranged between 11.8-17.2x, with an average of 13.6x. We revert to our original valuation methodology of valuing Tata Motors' core operations on CEPS – over the interim we had moved to an EV / EBITDA methodology to negate the impact of TAMO's financial services business on its core earnings and the balance sheet. But after the transfer of Tata Motors' vehicle financing business into a separate entity, we revert to our original CEPS methodology, which we believe best captures the intensely growth cyclical nature of TAMO's business, whilst also 'smoothing' the impact of capital intensity as the company's product cycles evolve.

We also revise our subsidiary valuations to Rs 257/share from Rs 202 earlier reflecting better performance at Tata Telcon and Tata Daewoo subsidiaries, and also incorporate value for Tata Capital.

Figure 1. Tata Motors- Sum of Parts Valuation

Name	Multiple	Rs/share
Core Business	11x FY09E CEPS	657
Tata Daewoo	12x FY09E EPS	48
Telcon	20x FY09E EPS	112
Tata Tech	20x FY08E EPS	9
Tata Motor Finance	2x FY08 BVPS	32
HVTL	10x FY09E EPS	11
HV Axles	10x FY09E EPS	11
Tata Steel	25% discount to Tata Steel Mcap	34
Total Value of Subsidiaries		**257**
Total TAMO Share Value		**914**

Source: Citi Investment Research

We revise our earnings downwards by 36-38% over FY08 and FY09 driven by lower growth assumptions in the MHCV segment and also pare our margin assumptions, to reflect input cost pressures.

Figure 2. Earnings Revision

	FY08E			FY09E		
	Old	**New**	**% change**	**Old**	**New**	**% change**
Net Sales	282,985	267,327	-5.5	331,010	313,774	-5.2
% change	13.8	-0.3		17.0	17.4	2.4
EBITDA	34,309	22,796	-33.6	40,484	29,342	-27.5
Margin (%)	12.1	8.5		12.2	9.4	
Net profit	22,523	17,924	-20.4	25,411	17,030	-33.0
EPS	55.6	34.4	-38.2	62.7	40.0	-36.2
CEPS	75.1	51.4	-31.6	86.3	59.8	-30.7

Source: Citi Investment Research

3QFY08: Above Expectations, Driven by Better Operating Performance

Figure 3. Tata Motors- 3QFY08 Operational Results

	3Q FY07	3QFY08	% chg YoY	CIR Comments
Volumes (Nos.)				
H / MCVs	48,079	47,042	-2.2	Domestic passenger segment grew by 15% YoY and goods segment declined by 3%
LCVs	38,448	45,347	17.9	Strong performance of Ace and its new variants continues
Total CVs	**86,527**	**92,389**	**6.8**	
UV s	11,694	11,767	0.6	
Cars	43,402	39,823	-8.2	Impacted by loss of market share to Maruti due to lack of new model launches
Total Passenger	**55,096**	**51,590**	**-6.4**	
Total	**141,623**	**143,979**	**1.7**	
Product mix (%)				
H / MCVs	33.9	32.7		
LCVs	27.1	31.5		
UV s	8.3	8.2		
Cars	30.6	27.7		
Market share (%)				
H / MCVs	64.2	63.7		Market share loss to Eicher Motors
LCVs	65.4	61.4		
UV s	15.5	17.7		Increase in market share attributed to new model launches
Cars	14.1	11.5		Loss of market share to Maruti

Source: Company, Citi Investment Research

Figure 4. Tata Motors- 3QFY08 Financial Results

	3Q FY07	3QFY08	% chg YoY	CIR Comments
Gross Sales	79,158	83,644	5.7	4% YoY increase in average realizations, 2% due to pricing impact and 2% due to product mix
Less: Excise duty	10,906	11,125	2.0	
Net sales	**68,252**	**72,518**	**6.3**	**2% above estimates**
Decrease/(Increase) in Stocks	(1,355)	(1,398)		
Raw Materials	48,976	51,820	5.8	
Staff costs	3,581	4,078	13.9	Reflects increase in employees for ramp up related to new products
Other Expenses	8,845	9,821	11.0	
Total Expenditure	60,046	64,321	7.1	
EBITDA	**8,206**	**8,197**	**-0.1**	**15% above estimates**
Forex gains	1,316	275		Includes 96.4 million gain related to translation of forex debt
Product Development	287	147	-48.8	
Interest	852	918	7.7	
Other income	143	268	87.2	Excludes gain related to stake sale of 11% in HV Axles
EBDT	8,527	7,676	-10.0	
Depreciation & Amortization	1,435	1,675	16.7	In line with estimates
PBT	7,092	6,001	-15.4	
Exceptional income		650		Gain on 11% stake sale in HV Axles to Tata Capital
Exceptional expenditure	(5)	-		
Tax	1,956	1,661	-15.1	
PAT	5,132	4,991	-2.8	
PAT (recurring)	**5,135**	**4,157**	**-19.0**	**8% above estimates**
Profit Margins (%)				
EBITDA (%)	12.0	11.3		120 bps above forecast
Tax / PBT (%)	27.6	24.0		
Net profit margins (%)	6.5	5.0		
Raw materials / sales	69.8	69.5		150 bps below forecast
Staff costs / sales	5.2	5.6		
Other expenses / sales	13.0	13.5		

Source: Company, Citi Investment Research

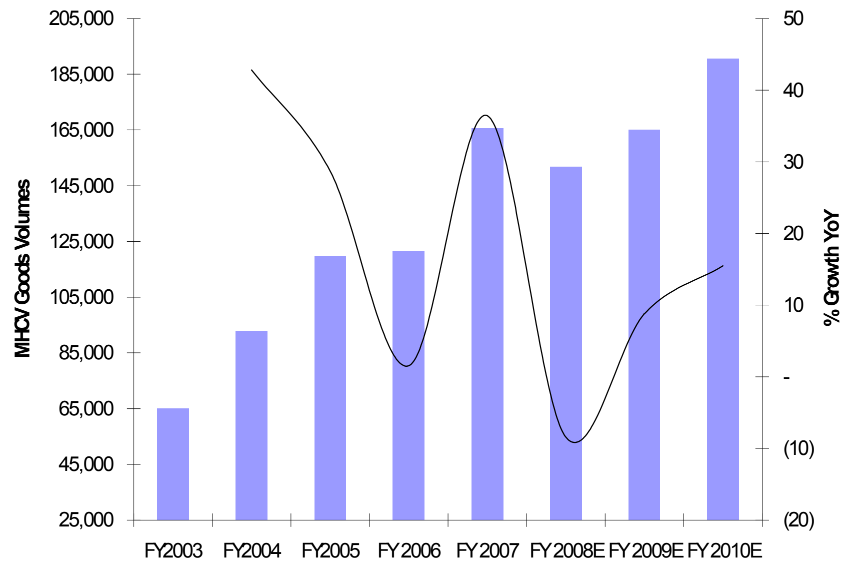
Core Business to Turn Around from FY09e

We expect the core auto business to register moderate growth over the period FY08E-10e, driven by a recovery in CVs and a surge in bus demand. Moreover, the moribund performance of the passenger car business this fiscal should be reversed from FY09, as TAMO replaces its jaded Indica / Indigo platforms with new platforms.

Commercial Vehicles (Trucks): 13% volume growth forecast over FY08-10e

Truck sales in FY08 underwent a correction due to overcapacity in the system - created by advance purchases by truck operators from Dec05-Sept 06 as the overloading ban was enforced. We believe heavy trucks will see a 7-8% decline in growth in FY08 before rebounding sharply in F09 and FY10 basically due to two reasons: 1) Continued healthy growth in industrial production, and 2) Strong replacement demand due to implementation of emission norms in 2010.

Figure 5. Tata Motors – MHCV Goods YoY Growth – FY03-FY10E



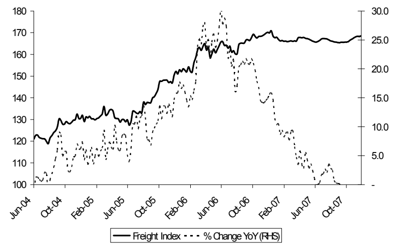
Source: SIAM, Citi Investment Research

Underlying freight market remains firm…

…But uncertainty over fuel price hikes could defer purchases of trucks

Anecdotal checks with truckers and also fleet operators suggest that the underlying freight market remains firm. Trucker profitability has remained steady – but not risen substantially – over the past one year – a hint that despite the strong growth environment, the trucking industry has been in a state of temporary overcapacity. Whilst all indicators suggest that the recovery is inevitable and should occur by early FY2009, we think that there is a possibility that this recovery might occur later, as a diesel fuel price hike is expected in the short run. Short term purchase decisions will be impacted by the extent to which the price hike is absorbed and passed on. Given that fuel accounts for an estimated 55-60% of operating revenues, a 5-6% uptick in freight rates would indicate that pricing power has returned to the trucking industry, and the overcapacity has receded.

Figure 6. Monthly Freight Index



Source: Citi Investment Research

Bus sales expected to accelerate, driven by improving STU finances

We expect 15% CAGR in volumes for TAMO over the period FY08-10e, driven by STUs upgrading the product profile in intra-city transport and also increasing levels of inter-city travel. According to a recent press article (Source: Business Line), STUs (State Transport Undertakings) in several states / cities like Andhra Pradesh, Uttar Pradesh, Bangalore and Tamil Nadu have recently turned profitable. This, along with the low penetration rates (we estimate less than 1 per thousand people), should drive bus demand over the next few years. We expect large orders even from loss making entities like the DTC (Delhi Transport Corporation), which is ordering 8,000 buses ($1bn order) in anticipation of the 2010 Commonwealth Games.

Tata Motors appears well positioned to meet this demand over the next few years, with its recently introduced range of *Starbus* and *Globus* range of buses (for intercity and intracity travel). Moreover, the company has also entered into a JV with Marco Polo of Brazil to manufacture intra – city buses. In addition, it has an equity stake in Hispano Carrocera, a Spanish manufacturer of luxury buses.

Along with domestic growth, the company also targets export markets for its buses – these markets comprise 27% of overall bus volumes for TAMO, accounting for a fairly significant amount. With its strategic tie ups with Hispano (which has a manufacturing facility in North Africa), the company hopes to increase its presence in the African continent, while targeting traditional markets in S. E. Asia.

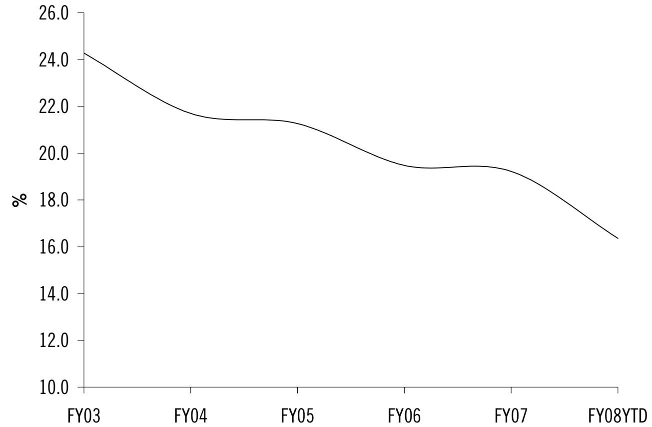
Light Trucks: *Ace* should continue to outperform

As the hub-and-spoke model continues to evolve, we expect Tata Motors' *Ace* to show robust 25% CAGR growth over FY08-10e. Growth should be spurred through market share gains from the large goods three wheelers, as intra-city transport burgeons and the need for a 'last mile' transport solution arises. To meet demand, Tata Motors has established a new plant for the *Ace* at Pantnagar, Uttar Pradesh (overall capacity of 225,000 vehicles).

Passenger Vehicles: New Models to Spur Growth

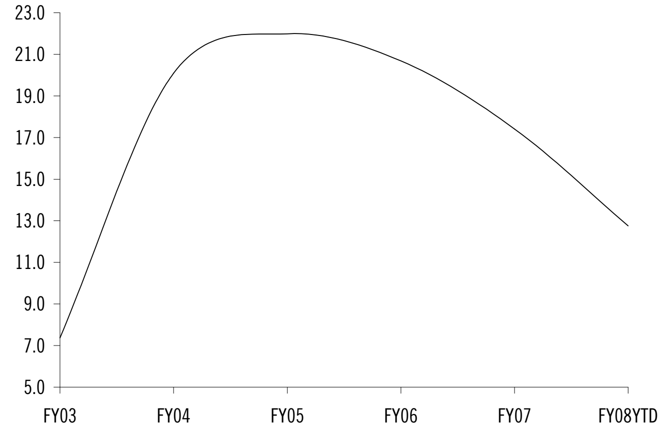
Tata Motors' domestic passenger car volumes have declined 3.3% YTD, a phenomenon largely attributed to its ageing product portfolio.

Figure 7. Tata Motors- Domestic A2 Segment Market share (%)



Source: SIAM, Citi Investment Research

Figure 8. Tata Motors- Domestic A3 Segment Market share (%)



Source: SIAM, Citi Investment Research

We reckon that CY08 (FY09) will be a watershed year for TAMO's passenger car business as it is expected to launch new hatchback and sedan models on the new *Indica* platform (Q2FY09). We expect the *Indica / Indigo* replacements to be equipped with Fiat engines (both petrol and diesel variants), bridging the gap in terms of product engineering with other competing products.

In addition, the "1 lac car", which was showcased at the Auto Expo in early 2008, will be commercially produced from 3/4QFY09. Our forecasts assume 50,000 and 200,000 units of sales respectively in FY09/10e. We assume that EBITDA margins on this product are substantially lower (~5%), but don't expect it to have a significant impact on operating profits, as we reckon that in 2010, this product would comprise c.5% of overall revenues. Overall, we forecast 57% CAGR in passenger car volumes over FY08-10e (inflated because of the small car)

The company is also expected to launch a new UV platform in FY09, which would replace its *Sumo / Safari* platforms. We would expect some elements of the Tata TL 4x4 in this new platform. Given management's strategy to develop global platforms, we would not rule out manufacture of aggregates or even assemblies in low – cost geographies like Thailand (where a JV with Thonburi is already being established to manufacture pick ups), with the vehicle being sold in SE Asia.

Financial Assumptions and Estimates

Figure 9. Volume Assumptions – FY06-FY10E

	FY06	FY07	FY08E	FY09E	FY10E
M / HCVs	136,871	184,997	174,623	191,378	220,812
% growth	1.1	35.2	(5.6)	9.6	15.4
LCVs	108,151	149,241	164,081	187,706	209,814
% growth	45.7	38.0	9.9	14.4	11.8
UVs	39,791	49,525	60,421	66,463	76,432
% growth	7.5	24.5	22.0	10.0	15.0
Cars	169,316	195,189	184,000	263,402	456,082
% growth	10.7	15.3	(5.7)	43.2	73.2
Total 4 wheelers	**454,129**	**578,952**	**583,124**	**708,948**	**963,140**
% growth	13.7	27.5	0.7	21.6	35.9

Source: Citi Investment Research

Figure 10. Tata Motors: Profit and Loss Statement- FY07-FY10E

	FY 2007	FY 2008E	FY 2009E	FY 2010E
Net sales	268,103	267,327	313,774	386,844
% change YoY	32.9	-0.3	17.4	23.3
Raw material expenses	190,253	190,559	219,368	270,160
% of sales	70.96	71.28	69.91	69.84
Manpower expenses	13,678	15,320	18,077	21,331
% of sales	5.1	5.7	5.8	5.5
Other variable expenses	21,401	21,921	26,482	32,572
% of sales	8.0	8.2	8.4	8.4
Other fixed expenses	22,024	23,732	27,004	31,800
% of sales	8.2	8.9	8.6	8.2
Less : Expenses Capitalized	5,771	7,000	6,500	7,000
Cost of sales	241,586	244,531	284,432	348,864
% of sales	90.1	91.5	90.6	90.2
Operating Profit	**26,518**	**22,796**	**29,342**	**37,980**
Interest	3,131	3,600	4,752	5,798
Other income	7,048	6,813	6,549	7,018
Depreciation	6,713	7,229	8,431	10,551
Exceptionals	2,010	4,200	-	-
Pre-tax profits	25,732	22,980	22,707	28,649
Tax	6,597	5,056	5,677	7,162
Net profit	19,135	17,924	17,030	21,487
Pre exceptional net profit	17,640	14,648	17,030	21,487
Profit Margins (%)				
Operating profit	8.5	7.3	8.1	8.5
EBIT	6.4	5.0	5.7	6.1
Effective Tax rate	25.6	22.0	25.0	25.0
No. of O/S shares (Mils, FD)	405	426	426	426
EPS (Rs)	43.5	34.4	40.0	50.4
Dividend / share (Rs)	14.3	11.3	12.2	14.5
Dividend payout ratio (%)	32.8	32.9	30.6	28.7

Source: Company reports, Citi Investment Research estimates

Tata Motors

Company description

Tata Motors is the flagship company of the Tata Group, India's largest business conglomerate, and is among the country's largest manufacturers of automobiles with a dominant position in the commercial-vehicle business. It has a significant presence in the utility vehicle and passenger-car segments.

Investment strategy

We maintain our Buy/Low risk rating on Tata Motors as we believe Tata Motor's new products in commercial and passenger vehicles will help Tata Motors regain lost market share in the respective segments. We also believe that commercial vehicle demand will revive in FY09 due to new and replacement demand.

Key reasons for a strong growth outlook in commercial vehicles include a sustained pick-up in economic activity, a focus on infrastructure spending (expected to continue with funding in place) and a strong replacement cycle (27% of the existing fleet in India is more than 15 years old and needs to be replaced both for commercial and environmental reasons).

Valuation

Our revised target price of Rs914 (formerly Rs1,029) is based on a sum-of-parts valuation methodology, which we believe captures the value embedded in subsidiaries and group holdings. Management has indicated its intent to unlock value, (to the benefit of Tamo's existing shareholders), for either / both HV Transmissions Ltd. and HV Axles Ltd., through an IPO or strategic sale to outside parties.

We value Tata Motors' core business at Rs 657/share, which is based on 11x FY09E CEPS, at the lower end of the recent trading band, and which should be comfortably supported by a 21% CAGR in cash earnings over FY08-10E. Over the past fiscal, the CEPS multiple has ranged between 11.8-17.2x, with an average of 13.6x. We revert to our original valuation methodology of valuing Tata Motors' core operations on CEPS – over the interim we had moved to an EV / EBITDA methodology to negate the impact of TAMO's financial services business on its core earnings and the balance sheet. But after the transfer of Tata Motors' vehicle financing business into a separate entity, we revert to our CEPS methodology. We value the subsidiaries at Rs257/share (in the table below).

Figure 11. Tata Motors- Sum of Parts Valuation

Name	Multiple	Rs/share
Core Business	11x FY09E CEPS	657
Tata Daewoo	12x FY09E EPS	48
Telcon	20x FY09E EPS	112
Tata Tech	20x FY08E EPS	9
Tata Motor Finance	2x FY08 BVPS	32
HVTL	10x FY09E EPS	11
HV Axles	10x FY09E EPS	11
Tata Steel	25% discount to Tata Steel Mcap	34
Total Value of Subsidiaries		**257**
Total TAMO Share Value		**914**

Source: Citi Investment Research

Risks

We rate Tata Motors Low Risk based on our quantitative risk rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price are movements in economic variables — particularly GDP growth, interest rates and fuel prices, to which sales of commercial and passenger vehicles are very sensitive. Competition in the passenger car business remains intense with the presence of most global majors in the Indian market. While the commercial vehicle business has been relatively less exposed to competition, the situation could change over the next three years with international companies eyeing the Indian market. Key upside risks to our target price include: a) Strategic sale/IPO of key subsidiaries; b) An indication that the Supreme Court ruling on overloading is being implemented over the longer term; and c) Reduction in input costs (notably steel).

Appendix A-1

Analyst Certification

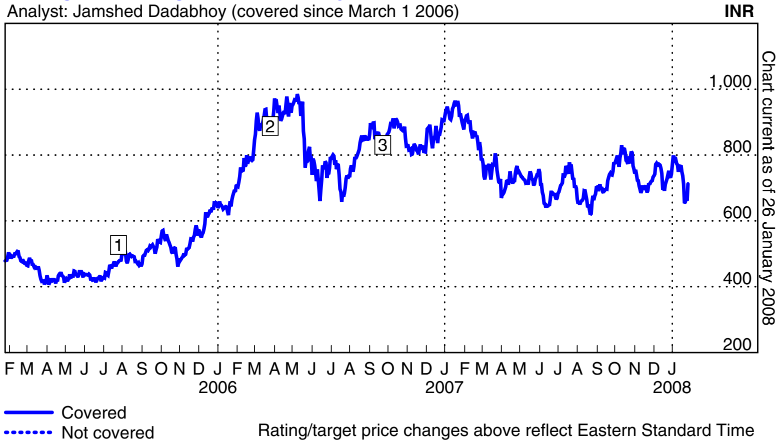
Each research analyst(s), strategist(s) or research associate(s) responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst, strategist or research associate covers in this research report, all of the views expressed by that research analyst, strategist or research associate in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s), strategist(s) or research associate(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst, strategist or research associate in this research report.

IMPORTANT DISCLOSURES

Tata Motors (TAMO.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Jamshed Dadabhoy (covered since March 1 2006)



Rating/target price changes above reflect Eastern Standard Time

#	Date	Rating	Target Price	Closing Price
1:	26 Jul 05	*1L	*656.00	476.50
2:	27 Mar 06	*2L	*974.00	901.35
3:	22 Sep 06	*1L	*1,029.00	835.45

*Indicates change.

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